“Divi’s Laboratories Q2 FY21 Earnings Conference Call”

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MANAGEMENT: **DR. MURALI K. DIVI – MANAGING DIRECTOR, DIVI’S LABORATORIES**
MRS. NILIMA MOTAPARTI – WHOLETIME DIRECTOR, COMMERCIAL, DIVI’S LABORATORIES
MR. M. SATISH CHOUDHURY – COMPANY SECRETARY & CHIEF INVESTOR RELATIONS OFFICER, DIVI’S LABORATORIES
MR. L. KISHORE BABU – CHIEF FINANCIAL OFFICER, DIVI’S LABORATORIES
MR. VENKATESA PERUMALLU PASUMARTHY – GENERAL MANAGER, FINANCE AND ACCOUNTS, DIVI’S LABORATORIES

Moderator: Ladies and gentlemen, good day and welcome to the Earnings Conference Call of Divi's Laboratories for the Q2 of Financial Year 2021. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. M. Satish Choudhury. Thank you and over to you, sir.

M. Satish Choudhury: Good afternoon to you all. I am M. Satish Choudhury, Company Secretary and Chief Investor Relations Officer of Divi's Laboratories Limited. I welcome you all to the Earnings Call for the Quarter-ended 30th September 2020. From Divi's Labs, we have with us today, Dr. Murali K Divi - Managing Director; Mrs. Nilima Motaparti – Whole-time Director (Commercial); Mr. L. Kishore Babu - Chief Financial Officer and Mr. Venkatesa Perumallu Pasumarthy - General Manager (Finance and Accounts).

During the day, our Board has approved the results for the quarter and we have released the same to the stock exchanges as well as updated the same in our website.

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Let me draw your attention to the fact that on this call, our discussion will include certain forward-looking statements which are predictions, projections or other estimates about future events. These estimates are management's current expectations of the future performance of the Company. Please note that these estimates involve several risks and uncertainties that could cause our actual results to differ materially from what is expressed or implied. Divi's Labs or its official does not undertake any obligation to publicly update any forward-looking statement, whether as a result of future events or otherwise.

Now I hand over the conference to Dr. Murali K. Divi - Managing Director of the Company for opening remarks. Over to you, sir.

Dr. Murali K. Divi: Good afternoon to all of you. I welcome you all for the earnings call of Divi's Laboratories. Hope you are all doing well. First, let me update you on global scenario on pharma and COVID-19 pandemic. COVID-19 has heavily impacted several industries, small, medium and large. Pharma industry as such is less impacted because of need for life saving medicines. This also created responsibility for discovering and manufacturing new APIs, antivirals, and vaccines. The developed APIs, Hydroxychloroquine, Favipiravir and Remdesivir have added only marginal medical benefit and not become life-saving drug or none of them can be used as prophylactic drug. A new drug is required which can prevent the infection whereby it can be used prophylactic

when in doubt of contacting the virus. The new drug is also expected to reduce the viral load quickly so that patient will not have severity of infection. There are a few drugs in phase II / III promising which may give hope to the whole world. How soon vaccine will be launched is still a big question mark.

I will cover little CSR activities. As a corporate under CSR, Divi's Labs is continuing, helping 98 villages around our factory. Several programs have been taken up by the Company or sanitation in view of COVID, COVID-support activities, safe drinking water, promoting education, preventive health care, village development, livelihood enhancement, empowering women, environmental sustainability, Swachh Bharat and a few.

On CAPEX programs, our project is though delayed due to migrant workers in Q1, now they are functioning fully and have completed some of the important projects. Rs.614 crores have been capitalized during the quarter. Several debottlenecking projects were completed. The remaining projects will be completed before end of the financial year. All the backward integration projects were completed. And this not only gives us assurance of supply but also brings us savings by reducing cost of materials.

A few new blocks are planned for new major Custom Synthesis opportunity are under construction and erection of equipment on fast track. This investment of CAPEX is to the tune of Rs.400 crores. This new CAPEX is in addition to the Rs.1,800 crores of CAPEX planned earlier. The majority of the utility expansion is completed. Rs.500 crores of CWIP projects are expected to be completed before the end of this financial year.

Now, I ask "Nilima to brief on Operations." Thank you.

Nilima Motaparti: Hello and welcome, everyone to Divi's Labs Earning Call to discuss the unaudited results for the second quarter ended 30th September 2020. I hope that each one of you along with your friends, family are safe considering continued existence of COVID-19 pandemic and the sudden incessant rains witnessed recently in several parts of the country. Although COVID-19 crisis continues, we have improved in terms of adapting in our everyday life and businesses during this quarter when compared to Q1. At Divi's, we are closely monitoring the constantly changing and evolving situation relating to this pandemic as we continue to strive and sustain our operations at a normal pace. Challenges like fluctuation in cost and availability of raw material and supply chain issues have reduced compared to the last quarter and we are optimistic in ensuring the uninterrupted supply of our APIs. Our response to the straining COVID-19 at workplace, stays constant and consistent with our main agenda being the safety and well-being of our employees. All protocols like thermal scanning and sanitization, social distancing and safe transport facility continue to be implemented and shall remain so until further guidelines from WHO, CDC and local governments are given.

The company has put in place several measures to keep up the business continuity and also sustaining steady supply chain network and servicing to our customers.

Moving on to our "Q2 FY'2021 Financial Performance." As you all are aware, we are implementing a large CAPEX program during the current half year. We have capitalized assets of Rs.830 crores. Of this the new SEZ account of Rs.524 crores and Rs.132 crores is for wastewater treatment facility and utility expansion at EOU. We have also capitalized assets at other units for augmenting capacities as well as utility infrastructure. We have capital work-in progress of Rs.499 crores as of 30th September.

On operations, I am happy to state that we have achieved consolidated sales revenue of Rs.1,749 crores during the quarter, reflecting a growth of 21% over the corresponding quarter of the previous year. Profit before tax for the quarter amounted to Rs.693 crores, a growth of 42%. We earned profit after tax of Rs.520 crores during the quarter, reflecting a growth of 46% year-on-year. Exports accounted to 87%. We continue to have normal business distribution across regions and Europe and US accounted for 71% of our revenue. Product mix for generics and Custom Synthesis is 60% and 40% of the revenue respectively. Constant currency growth for the quarter has been 18%. Our Nutraceuticals business amounted to Rs.167 crores for the quarter and Rs.294 crores for the half year.

Thank you. With this we would like to request the moderator to open the line for Q&A.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Vishal Biraia from Aviva Insurance. Please go ahead.

Vishal Biraia: Sir, what led to the urgent need for expansion of the Custom Synthesis capacity and how soon do you plan to complete it, is it because of movement from China to India or some other factors, could you elaborate a bit more on this please?

Dr. Murali K. Divi: Historically, I think you all have good experience at Divi's that we do not invest just because we have funds. When we foresee an opportunity, we start investing. But this time in the last two quarters, more in the last one quarter we have seen from the very big pharma of international, Europe and US, we have received some very fast-track projects with a lot of incentivization and these projects will have a very high return and we need to finish them on a war foot basis and these projects we have been doing, these are the ones we are planning for Rs.400 crores and we have to complete in the next six to nine months.

Vishal Biraia: And the next question is on the contribution of COVID-related drugs to revenue and EBITDA?

Dr. Murali K. Divi: In the second quarter, what we are reviewing right now, there is almost zero…I think, I do not know a few lakhs whether it is involved, otherwise we had no income from the COVID.

Moderator: Thank you. The next question is from the line of Prakash from Axis Capital. Please go ahead.

Prakash: Sir, if you could help us understand gross margin expansion both YoY and QoQ? Sales mix if I see Custom Synthesis to Generics, more or less similar, so not much change there. So in terms of product mix what has changed and given the supply disruption, pricing is healthier if there is some commentary there?

Dr. Murali K. Divi: I think we have been saying always that it is very difficult to go by quarter-on-quarter between Custom Synthesis and Generics. Definitely, with the investment of Rs. 1800 crores plus the additional Rs. 400 crores, we have already completed the debottlenecking project as I mentioned a few minutes ago and we have also completed some of the expansion plans. And what we are looking at now is after validation, there is a gestation period of anywhere from six months to 1.5 years for the regulatory authorities to clear the products and also the customers validating the fresh products at their facilities. As we pass you will see the incremental quantities in the quarters.

Prakash: But I just wanted to understand what would be the sustainable levels actually? I mean I understand quarterly fluctuations could be there. But with this debottlenecking and all say 64% to 65% is sustainable or we should model in 60% to 63% of the gross margin?

Dr. Murali K. Divi: So what people concentrate on how to save tax money and people concentrate on other things. But I think the majority of the expenditure is on the raw material, the majority of expense is on overheads plant expenses. I think if you look at the several balance sheets, we have been able to hold on to around 55% to 60% quarter-on-quarter; that's why we are able to retain good profit. And I think going forward, yes, we should be able to do 60% definite if not better. Now you commented the backward integration and other projects being complete. Definitely, yes, as I mentioned that, it not only gave us assurance of supply but also definitely with the new technologies we introduced, with maximum efficiency and high productivity, our material costs have come down. I think it is a combination of all these what you are seeing better numbers. Do not go by quarter-on-quarter. I think we can definitely continue what we are doing.

Prakash: My second question is on the CAPEX. So Rs.4 billion exclusively for Custom Synthesis but for the 18 billion that we announced some 18 months back, so of that I understand 3 billion is for debottlenecking and 6 billion for each of these unit-1 and unit-2. So I wanted to understand on that, 12 billion, what portion or what percentage is attributed towards Custom Synthesis capacity?

Dr. Murali K. Divi: Again, blocks are not meant just for Custom Synthesis or for generic. The buildings are all multi-purpose; they can produce either a generic product or a Custom Synthesis product depending upon the need in the campaign. Some buildings are, yes, dedicated to a generic product or dedicated to a Custom Synthesis product depending upon demand, but on overall whatever we have completed we are able to utilize between the DCV-SEZ and DC-SEZ. In the backward integration, we are able to use them fully. In the generics, we are able to qualify and start producing, and some products we have been able to export without waiting for the regulatory

authorities, some of them we are waiting and in Custom Synthesis debottlenecking project they are yielding some of the customer sales already.

Moderator: Thank you. The next question is from the line of Bharat Shah from ASK Investment Managers. Please go ahead.

Bharat Shah: There was a case against the company officials in SEBI. Recently that has been closed now. I want to know what is the status in terms of the stance of the company about those individuals?

Dr. Murali K. Divi: The people who are involved have settled the issue with SEBI. Company has always been compliant to the code of conduct and business ethics and shall ensure compliance as well.

Bharat Shah: I am not talking about company being compliant or not. I am asking there was this case. Now I believe that has been compromised and there has been a compensation paid by the individuals concerned. What is company planning to do about it is what I am asking you, if you can formally clarify that will be helpful?

Dr. Murali K. Divi: I think the company has nothing to say.

Moderator: Thank you. The next question is from the line of Shyam Srinivasan from Goldman Sachs. Please go ahead.

Shyam Srinivasan: My first one is on the Generic API segment. It has grown faster than the 21% that was called out based on the numbers that you shared on the call. So just want to know what are some of the building blocks, how much is price, is it largely volume-led or have there been new products that have been introduced, if you can give some qualitative color?

Dr. Murali K. Divi: We are fortunate that the debottlenecking and capacity expansion projects we have done, Naproxen, for example, 5,000 tons, Gabapentin 2700 tons; Valsartan, Levetiracetam, Levodopa, Pregabalin, Mesalamine, all these products, we have debottlenecked the capacity substantially and we are able to start selling the product without compromising on price and I think this is what you are seeing increased sales. And going forward yes, we did debottlenecking and some of the expansions which we have done on totally new blocks that needed to get some regulatory clearances because when we upgrade new blocks, we always introduce new technologies, new ways of working so that the productivity goes up and also the material cost come down, minimizing the waste. So all these will sometimes be viewed as a change, two three smaller changes become a medium change which we are waiting for customers' clearance. So as and when they come, you will also see some more increase in sales in the generic products.

Shyam Srinivasan: My second question is on the Custom Synthesis. Could you actually talk us a little bit about qualitatively in terms of the number of projects that we have actually started doing, are they linked in some form or shape to COVID or this is in general the non-COVID portfolio as well? I thought you said Phase-3, I could not pick up that comment clearly as well, so if you could

share some comments around the Custom Synthesis business and also linking to the point about the Rs.400 crores additional you talked about war footing, so just trying to piece together the entire Custom Synthesis segment sir?

Dr. Murali K. Divi: We have never been giving details on how many in Phase-2, how many in Phase-3 and information on these projects because the existence of the confidentiality agreement with any company is highly confidential. That is why I am not in a position to explain how many projects with which companies and what we do. But therapeutic segments, I am willing to talk. Yes, some of these expansions are for some of the discovery of COVID drugs, some of these are for some other therapeutic segments, it is a combination. The chemistry does not know whether it is for COVID drug or a cancer drug or blood pressure drug or something else. What we know is 24-named organic synthesis reaction. So a combination of few of the reactions can produce an anti-COVID drug or can produce anti-cancer or anti-ulcer or anti-blood pressure drug. Yes, we are involved in a combination of these therapeutic segments in the Custom Synthesis. That is why we have received some very fast track projects and with a lot of incentivization and we have to thoroughly do them. This is where the additional new Rs.400 crores is going.

Moderator: Thank you. The next question is from the Girish Bakhru from Bank of America. Please go ahead.

Girish Bakhru: Last quarter you mentioned that there is a possibility of new units starting production and products and same technologies you could have launched from those facilities without inspection. Can you update on that if that has happened and similarly any color on when inspection can happen of these two units?

Dr. Murali K. Divi: When I mentioned in the last concall, the unit-1 and unit-2 are situated in 500 acres, each site. These are two sites with 500 acres each, where at unit-2 we call it new DCV-SEZ as a unit in about 60-acres of land. So, this unit is on the 500 acres site taken, and site is already cleared by US-FDA. So the new units we have built, usually they do not require (approvals) if I am using the same technology and if it is for the same product. I can start exporting immediately by keeping some batches in stability. If I am making a new product or utilizing totally a new technology in these blocks, then of course I need to wait for the clearance of the (regulators) whether it is US-FDA or EU or others. So what I would say is that unit-I also where in this DC-SEZ where we are investing Rs.600 crores plus; again, the same total facility is US FDA inspected, the new blocks we are constructing in this DC-SEZ where some of it is backward integration, some of it is for the new products, we should be able to utilize part production and where we need clearances from the EU, US., We have to wait.

Girish Bakhru: And the second question was on the mix. I realize this new investment in Custom Synthesis is meaningful from a near-term opportunity but can you give possibly some color on how generic versus Custom Synthesis mix will change over two years if that is possible that will be very helpful?

Dr. Murali K. Divi: The ratio always we would like to maintain 50% to 60% each, however, the customers in generic and the Custom Synthesis projects decide whether it would be 60 or 40, maybe for a few years Custom Synthesis will take a lead and again generic may catch up.

Moderator: Thank you. The next question is from the line of Surya Patra from PhillipCapital. Please go ahead.

Surya Patra: Sir, regards the cumulative CAPEX of Rs.1,800 crores that we have done, so given the kind of enhanced productivity or improved profitability, what we are seeing since last couple of quarters, so is it fair to believe the asset turn of this newly added CAPEX would be higher than the asset turns what our old assets are currently getting, the older effects in fact generating a revenue, asset turn of something like 1.5, for new fully added CAPEX is it fair to believe slightly better than the historical trend?

Dr. Murali K. Divi: The CAPEX we discussed earlier was Rs.1800 crores between two sites. Some of it was debottlenecking which we completed, some of it was backward integration, upgrading utilities, QC infrastructure and the modern waste water treatment plants at both sites. Again, all these are looking at five years, ten years, 15-years down the road preparing for new regulations that would come in addition to increasing capacity. The Rs.400 crores what we are talking about is purely on Custom Synthesis which contracts being in other words the assurance and agreements being in place, it is not that we are looking at projects anticipating business building which used to be the case whereas now the business is in place and how to complete this Rs.400 crores project quickly for the business to happen.

Surya Patra: Just wanted to have a sense on the CAPEX, on the same question like having seen a kind of a strong phase of CAPEX over last current year and last year which is again continuing, so after this is it fair to believe that the CAPEX momentum will see some kind of stagnation there and before we identify a new site because Kakinada is also not seeing any progress from the administrative clearance side, so is it fair to believe that we might not see any major CAPEX going ahead in the near future and possibly a couple of years down the line once we see a optimal utilization level for the existing and new ones till the time it would be kind of a moderated CAPEX phase for company?

Dr. Murali K. Divi: Based on the opportunities we have, the existing sites probably will not require new capex whereas we have been planning our unit III near Kakinada, and Unit-IV near Nellore. These two units we have been planning to construct for a long time. Unit-III near Kakinada, the government has almost cleared everything, and we hope to start somewhere in December, January the construction activity. The CAPEX could be to the tune of about Rs.600 crores on that.

Moderator: Thank you. The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: Sir, a clarification on the CAPEX for Custom Synthesis business. So did you mention you expect to complete that project in another six to nine months and after that you can start executing orders which you have received from the customers?

Dr. Murali K. Divi: Yes, that is what I meant that these projects came in with incentivization that we need to complete on fast track, yes. And on completion, they would immediately go into production, yes.

Damayanti Kerai: Sir, on the Kakinada plant, I missed your comment. You mentioned you got the clearance from Government, right, and then you can start work there?

Dr. Murali K. Divi: Yes, we were waiting for the final clearances earlier. Now we have all clearances and we hope to start construction activities in December or January at the Kakinada plant.

Damayanti Kerai: Sir, any CAPEX plan for that?

Dr. Murali K. Divi: The CAPEX is about Rs.600 crores.

Moderator: Thank you. The next question is from the line of Alankar Garude from Macquarie. Please go ahead.

Alankar Garude: My first question is in the last few years we have seen the US contribution to overall sales coming down for us, while that from Europe has been increasing. Now, this is even applicable in the last two, two and a half years, when the direct impact of the import alert should not have been much. So, any particular reason sir which you would like to highlight for this and how should we look at the US contribution going ahead?

Dr. Murali K. Divi: It is very difficult to say that what we shipped to US or what we ship to Europe or what we sell in India or what we sell into the far east because the big pharmas have relocated several of their manufacturing facilities, are outsourcing the dosage forms to either European companies or at their tax havens in Ireland or Singapore or elsewhere. Our reporting is exactly on to where we are shipping the product than whether the company is headed in US or Europe or where it is. I think geographically it is different because several of the big pharmas have closed their plants and moved them either to Europe or elsewhere. That is why you are seeing the reporting that way. But even in India, for example, some of the contract manufacturing, formulations is happening by the big pharma from US and Europe, we have to ship for the big pharma to some companies in India whereby they export the dosage form. So I think our US business did not go down in fact, I think it is in good shape.

Alankar Garude: My second question is if we look at the top five customers for us, those account for about 35%, 36%, yes, that number has been coming down over the past few years, but generally in terms of client concentration, it is a bit higher than most of our global peers. So just wanted to understand

whether there are any conscious efforts to add more new clients and improve mining among some of these relatively newer clients?

Dr. Murali K. Divi: There is no plan like that as such. Probably it is happening because we have been growing at a faster rate and adding more customers and more products because when you add more products you will have more customers, that is what is happening or when you increase the capacity you always will have more customers. There is no plan that we want to add more customers, but definitely we want to add more products and more capacity.

Moderator: Thank you. The next question is from the line of Cyndrella Carvalho from Centrum Broking. Please go ahead.

Cyndrella Carvalho: Dr. Divi, if you could help us understand, out of the Rs.1,800 crores CAPEX that has been announced so far, how much have been able to utilize so far because we have capitalized most of it and some of it still remaining? And if you could help us understand out of the Custom Synthesis program that you have announced and the Kakinada that you specified would be around Rs.600 crores. So Custom Synthesis I understand that would be available from next year onwards itself. And by when can we expect Kakinada as it is a Greenfield that you would be starting?

Dr. Murali K. Divi: I think I mentioned that the debottlenecking programs, whereby some of the capacity would go up, have been completed and we are seeing some of that benefit, number one. Two, some of the capacity expansions for some of the generic products that also have started resulting in deep roots. Some projects as well as API we validated and we are waiting for the customer as well as the agency clearances. As we get the clearances, they will go into the production. Coming to the Kakinada investment, first it would take about a year or year and a half to complete the project, then it goes through the validation and qualification. So that investment would take time to give us returns maybe more than I would say project construction about a year, year and a half and sales start after another year and year and half; two to three years.

Cyndrella Carvalho: On the Brownfield CAPEX of Rs.1,200 crores, I understand that we have completed the backward integration as well as the EOU related CAPEX, but on the Brownfield how much we are able to utilize as of now?

Dr. Murali K. Divi: On the Brownfield also, there were backward integration projects as well as the new blocks. The backward integration already we are able to use about 20%, 30% of the capacity. Remaining of the buildings, we are waiting for the regulatory and others to clear the utilization.

Moderator: Thank you. The next question is from the line of Nitin Agarwal from IDFC Securities. Please go ahead.

Nitin Agarwal: What opportunities do you see in the Nutraceuticals business going forward? I mean this year has been a pretty good year from a growth perspective for this business.

Dr. Murali K. Divi: The Nutraceuticals business is growing about 10%-plus, plus that is the growth rate right now, maybe 10-15%, about Rs.600 crores is expected this year and going forward we are looking at 15% to 18% as we are reaching more and more markets. I think the trend in the industry is to go for more Nutraceuticals and I think there may be slightly disturbance with this pandemic but definitely the goal is that it will be more Nutraceuticals usage in the coming years and we are geared up to take all advantage by having backward integration of API as well as the formulation.

Nitin Agarwal: Secondly on the Custom Synthesis project that you talked about, just want to clarify is this a single project or it is a combination of projects for which you are putting the CAPEX for?

Dr. Murali K. Divi: It is a combination of projects from several big pharmas. It is not one project or two projects.

Moderator: Thank you. The next question is from the line of Ankush Agarwal from Stallion Asset. Please go ahead.

Ankush Agarwal: My question is on the CSM business. Can you help me understand a little bit on the business mix that we typically have in terms of projects that we undertake during the development phase of a molecule versus projects we take during the commercial phase of the molecule when we are the second supplier, if you can highlight something on this?

Dr. Murali K. Divi: I think you need a little more clarity because we are not in the clinical trial, we are not in the gram scale, we are not in the few kilogram scale. When it passes through Phase-I, that is when we enter into in Phase-2 that is when the chemistry will get locked up. So we enter not when the chemistry is in the nascent stage, we enter when the chemistry will be robust to produce in terms of quantities when we enter at stage-2, 3, so that the impurity profile can be controlled and the productivity can happen and the best technology can be used. So, our involvement is on phase-2, 3 and then be in the launch, then travel through the patent period. That is our process. We are not joining as a second supplier for an innovative product. That used to be the case, I am talking about 10-15 years ago, but now majority of products are new, entering in phase-2, 3 and yes, in some cases if the big pharma wants to source several hundred tons of it or they need all of a sudden several hundreds of tons, there are not many companies that can handle with resources and technology, with assurance and supply to cater to the needs of these big pharma with stringent EHS requirement, stringent quality requirements, regulatory requirements. This is where we are strong at.

Ankush Agarwal: So just to be clear, for the most part in the CSM business we enter during the phase-2, right?

Dr. Murali K. Divi: We enter in the phase-2, phase-3, yes.

Ankush Agarwal: And secondly sir typically the CSM business we do batch manufacturing and not the continuous manufacturing which is what my understanding is, is it right?

Dr. Murali K. Divi: That is right. 90% plus or 95% plus APIs are produced on a batch process basis. We are developing some technologies for continuous processing but I think there are some limitations, but we are able to implement continuous processing of at least certain stages or certain operations, where we need to really control either an impurity or a safety, we are able to implement, but as a product totally, it is not that you put raw materials in one end and the product would come out at the other end continuously, no. There is no such possibility in an API.

Moderator: Thank you. The next question is from the line of Lakshmi Narayanan from ICICI Mutual Fund. Please go ahead.

Lakshmi Narayan: Sir, on the Custom Synthesis business, approximately how many clients we have? What kind of repeat business we get on the CS business? And it is also mentioned that top five products contribute 47% of revenues. Does it have any Custom Synthesis product when you talk about these top five? The next question is that in terms of reactors, we have commissioned in DCV and we have put up some reactors. From the efficiency of reactors, what you commissioned earlier to now, how you improve the versatility and the size of reactors? So these are my two questions.

Dr. Murali K. Divi: I think your first question is the five products in the Custom Synthesis, how many companies we have. The existence of the relationship cannot not be disclosed number one; but definitely, we have many big pharmas as our clients and we do get repeat businesses because of the good business we do with them and good service we give them both supporting on-time, all the time, and quality products with no rejection. These are the minimum expectations and not only at the best cost, best quality and with all the EHS requirements and quality requirements and regulatory excellence.

Lakshmi Narayan: My question is among the top five products which you call out as 47% of your revenues. Does anything is in the CS business or everything is in the non-CS business,, top five products?

Dr. Murali K. Divi: Most of the business is from non-CS because we do enter at the phase-2, 3, but phase-2, 3, they are going to launch quickly. So, we do not do the 50 molecules in clinical trials and 80 molecules in clinical, we do not do that because the killing rate or death rate or whatever you call it, falling rate, is very-very high there, it is high risk. High reward? I do not know. But definitely, we are not in that business., We have been saying that from the beginning. On the question on reactors, yes, we have the traditional reactors what we were using is totally different from what we use now. From whatever is available in the market we changed to our own designs, both from the point of view of material of construction to the way it mixes, the way it can be multi-purposely used to arrive at the right particle size and right quality and right form. Because if you are making API, it is important today, you have to produce the right form and right particle size. So definitely the design of the reactor is very important today and it has changed a lot from the time we started.

Moderator: Thank you. The next question is from the line of Ritesh Rathod from Nippon India Mutual Fund. Please go ahead.

Ritesh Rathod: In the Custom Synthesis business, are you seeing additional enquiries from clients but you are not committing to them because you will wait for this current capacity build up to happen and the progress on that, you will wait and watch and then eventually you will commit to those kind of enquiries?

Dr. Murali K. Divi: I am in a fortunate seat, with all my discipline in holding on to my money instead of venturing into other activities, what I meant is that the Rs.1,800 crores of cash we have or Rs.1,000 crores of cash at any given time in my hand to invest on project expansion and come up with capacity. We have not turned down any project for any big pharma based on not having capacity or being not able to build capacity. We may have turned down these projects where the technology is not available with us like monoclonal antibodies or fermentation or steroids or hormones or the price pressure is so much on the therapeutic segment that we were not interested in the project. But looking at normal therapeutic segments, a good product, there is no way we would leave an opportunity. With all the capability and capacity to create or somehow accommodate because all our plants are multi-purpose, all our buildings are multi-purpose, so we could always make a product without any issue.

Ritesh Rathod: Sir, my second question would be how supportive is the Indian government, both state and central, in terms of your CAPEX execution and have you seen any major change in the stance from their support?

Dr. Murali K. Divi: Fortunately, I think for all the exports we do with the big pharmas, with all the funds we have in-house, it is only regulatory clearances we need from the pollution control board and various other governmental bodies and we receive excellent support from either the State or the Center. We absolutely no issue and we get a lot of encouragement.

Ritesh Rathod: My question was more post the recent PLI Scheme, are they incrementally more supportive in terms of clearance of approvals?

Dr. Murali K. Divi: I think we did mention even in the last concall that the PLI Scheme is not beneficial to us because the products that are involved in the PLI Scheme, majority of them are antibiotics and others, we are not in those products. And it is only Rs.2.5 crores they would give per product per applicant, and with the investment we are doing, Rs.2.5 crores would not make any dent.

Moderator: Thank you. The next question is from the line of Charulata Gaidhani from Dalal & Broacha. Please go ahead.

Charulata Gaidhani: My question is about the gross profit margin. There is a remarkable increase over the last three quarters. Can we assume it as a new base going forward or if you could give a range of margins?

Dr. Murali K. Divi: Every company wants to have better margins, we aim for same, but the CAPEX is not only for increasing the margin, as I mentioned that, CAPEX is to have these factories what we have, be ready to face all the regulatory challenges that are going to be posed in the next five, ten, 15-years from EHS to quality, regulations internationally, in addition to creating higher capacity with new technologies. While doing this backward integration and new technologies and new products, definitely, the margin should improve.

Charulata Gaidhani: So we can assume around 63% to 65% range for gross margins going forward?

Dr. Murali K. Divi: You know I have been very conservative from day one since '95, since I started the Company. I used to say 50%, now I have graduated to say 60%. I think my younger generation may say 70%, I do not know in future, when I retire and then they take over fully. But right now I am a very conservative person, 60% definite, is my saying. And always, see, the product mix is the problem, it is not; I want to drive it to 70%, but what happens in the product mix, one product goes down, one product goes up, a combination of these products makes it and some competition from all of a sudden come from nowhere to kill a product in generic, all of a sudden 20% percent less price available, should we sell or not sell. Our marketing team faces the challenges and sometimes they have to agree with the customer and reduce the price. So, I think it is fair to say that 60% can be maintained.

Charulata Gaidhani: And pertaining to the expanded capacity in Kakinada plant and Custom Synthesis, by when do you expect regulatory clearances?

Dr. Murali K. Divi: The Custom Synthesis Rs.400 crores expansion should start yielding from the very next year itself. As we complete the blocks, they have been produced. The Kakinada plant, it will take about three years because since it is Greenfield projects, take about one and a half years, and qualification batches and validation another one and half, about three years.

Moderator: Thank you. The next question is from the line of Naresh Suthar from SBI Life Insurance. Please go ahead.

Naresh Suthar: My question is regarding this 2Q number. So many of your peers have talked about the clients stocking the API for ensuring the continuity of their supplies and hence the preponement of some of their orders. So, have you also seen similar trends and that is why the second half would be similar or little lower than the first half?

Dr. Murali K. Divi: See, it is always that sometime they want just in time, that means they do not want any stock, they want stock as needed. They say for assurance of supply, please keep 30-days stock. So I think this is the management philosophy which keeps changing at the customer end time-to-time. However, I think all quarters cannot be same and we do not control anything, neither purchase orders nor shipment. So, our aim is to continue selling whatever we produce. You take for example, the Q3 almost every year that everybody who closes their financial year in

December they would say no-no, we do not want any stock, please postpone to the January, do not ship us from December 10th or December 15th. So, we do not manage any of that. It just happens. So, my request is do not judge us or donot go by quarter-on-quarter, look at year-on-year as overall, I think that will be a better way of looking at it.

Moderator: Thank you. Ladies and gentlemen, due to time constraint, we take the last question from the line of S Mukherjee from Nomura. Please go ahead.

S Mukherjee: Sir, just wanted some color on the API generic business. Now, you mentioned about debottlenecking and you mentioned the kind of volume that you are seeing in some of the older products like Naproxen, Gabapentin, etc., I would assume that these are very mature molecules and growing slowly. So, what is your expectation of growth here, will you be able to take more market share? And sir, going forward what would be the key driver whether it is the older basket of products or new APIs that would drive growth, if you can give some color?

Dr. Murali K. Divi: I think that was a good question. I think the problem is that my grandparents did not live more than 50 or 60 years but father lived 93. I am dreaming about whether I can reach 100. So when people are living longer, they need more life-saving drug support as long as they live. Most of the generic products, the Naproxen, Gabapentin, the sartans, the Levetiracetam, Levodopa, Carbidopa and Pragabalin, all these are life-style drugs and as you live longer, you have to use them till the end. So as a result, the growth may look smaller, when you say, 8% growth or year-on-year 10% growth or 6%, but when you look at a product of 8000 tons **of** Naproxen growing at 8%, you need another 650 tons in one year, and there is nobody to invest Rs.200, 300 crores for a 1,000 ton plant, whereas we are ready to invest. What we expanded is sold out. So my marketing man Mr. Prakash, Vice President, comes to me, "What is next sir?" You mean to say, you want me to build one more Naproxen block for another 2,000 tons? That is where we are in discussion already. The sense is both for the few other generic products. See it is like I think Aspirin, Paracetamol, Crocin, we still need and they are still expanding. It is having a better process and more profitability should be made by designing more newer process.

S Mukherjee:: One in the last call you talked about you are developing some of these COVID drugs like Remdisivir, intermediates and API maybe, but you mentioned there is no sale here. So I just wanted to get that clarification. And also sir, you mentioned about Nellore unit. Any timeline on CAPEX there and the quantum of CAPEX?

Dr. Murali K. Divi: Yes, when we developed the process for Hydroxychloroquine, Favipiravir API and also the advanced intermediates for Remdesivir, the intention was that if this would save the lives against pandemic, we wanted to make sure there is no shortage. But fortunately it seems that there is no shortage of these drugs, at the same time they are not fully being…I do not want to comment on the efficacy but I think, it is not that they are able to prevent the deaths totally. So we have not made any further batches after the initial production and whatever it is there probably the sales were there, that is why I made a statement saying there is no significant sale in this quarter,

maybe few lakhs. Going forward on the Nellore site, yes, we have the 200 acres of land, the wall been constructed and waiting for the clearances. First, I think we would construct the Kakinada plant and then we would go, it looks like**.**

Moderator: Thank you. I now hand the conference over to Mr. M. Satish Choudhury for closing comments.

M. Satish Choudhury: Thank you all for joining us today for the earnings call of Divi's Laboratories Limited. In case you need any further clarification, please reach out to our investor relations. Thank you.

Moderator: Thank you. Ladies and gentlemen, on behalf of Divi's Laboratories Limited, that concludes this conference. Thank you all for joining us and you may now disconnect your lines.